

# Chit Fund Scam\*

## A Game in Bengal

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*The exposure of Saradha Group's mega financial scam in Bengal popularly known as "chit fund scam" has had a devastating effect on the economy of the state, leaving the common people with trauma and severe investment phobia. Ironically, the chit fund scam pays tribute to the thrift and industry of Bengali workers where 'get rich quick' promises easily lured people to the trap of these kinds of funds. It severely indicts the negligence, greed and encouragement of our rulers. It would never have mushroomed to these enormous proportions if small people throughout the country side had the benefit of safe saving schemes according to their convenience. With each passing day, investigators dig deeper into the Saradha scam and new revelations send shock waves across Bengal. The paper seeks to portray how politics has been controlling the scam and attempts to highlight the political blame game of the Chief Minister and her team who refute charges hurled at them, while their political foes cry foul.*

The state of West Bengal has drawn global attention for its very recent mega financial scandal which has been a major financial scam and alleged political scandal caused by the collapse of a Ponzi scheme run by Saradha Group, a consortium of over 200 private companies that was believed to be running collective investment schemes popularly but incorrectly referred to as chit funds. The group collected around Rs, 2460 crores before it collapsed in April 2013.<sup>1</sup>

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<sup>1</sup>Times of India, 25th October, 2013.

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## **Why do People go for Chit Funds?**

India has a large low-income rural population. According to the World Bank the world has 872.3 million people below the new poverty line, of which 179.6 million people live in India<sup>2</sup> Decline in market interest rate, rapid financialization of household savings, lack of awareness and knowledge on capital market, absence of adequate deterrence and regularity enhances the growth of Ponzi companies.

Chit funds do not offer monetary flows alone. They promise land or residential flats in lieu of money as well. Apart from that, many of them engage in productive investment activity too, as have been proved by the growth of entertainment business, media, hotels and real estate enterprises. In spite of all this, the returns from these ventures are never as high as what the chit funds promise to return. The absence of Banks and Post offices in suburbs and rural areas attract the local people to invest in chit funds instead of keeping the money in safe pockets.

The get rich quick promises easily lure people to the trap of these kind of funds. Thus greed for higher interest and money is an important cause for the people to invest in the chit funds. Easy investment formalities of these fund schemes attract a large number of people. The customized investment schemes instead of a standard ‘fit all size’ bank schemes open up various investment options for the people at large. Most importantly, lack of development, inadequacy of information and easy savings scheme give rise to investment in chit funds among high mass of population in backward areas.

## **Scenario in Bengal**

Strictly speaking, the dozens of companies in the news of Bengal are not chit funds at all. They must be registered and regulated by the state government and operate like ‘kitty parties’ under the Chit Funds Act of 1982. By that definition, West-Bengal has only one chit fund. The others are all money-collecting schemes. Honest wage-earners, who cannot afford to put by more than a few rupees everyday, week or month, give the money in good faith. They make the sacrifice for a son’s education,

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<sup>2</sup>*The Economic Times*, 10th May, 2014.

a daughters marriage or old-age medical treatment. It's their insurance for the proverbial rainy day. Then, one fine morning, they find their savings gone.<sup>3</sup>

After the lid was blown off the Saradha Group's Scam in Bengal very recently, all Chit Fund Schemes are being viewed with suspicion and skepticism. However, chit fund operators elsewhere in India are making the point that all should not be tarred with the same brush and that far from duping subscribers, *bonafide* chit-funds actually work very well for small investors.<sup>4</sup>

Infact, the All India Association of Chit Funds (AIACF) has shot-off angry letters to several media houses, protesting against the loose use of the term "chit funds", to describe Residuary Non-Banking Finance Companies (RNBFC's) such as the Saradha Group that take public deposits, flouting all rules and regulations. The association that works closely with the Union finance ministry, says fraudulent RNBFC's in Bengal are giving good chit funds a bad name.

Ironically, the chit fund scam pays tribute to the thrift and industry of Bengali workers. It also indicts the negligence and greed of our rulers. It would never have mushroomed to these enormous proportions if small people throughout the country side had the benefit of safe saving schemes. Such swindles flourish only if authority allows or encourages them to do so. It was rumoured that the Left Front government delayed cracking down on a ponzi company *Sanchaita* until an important minister's family had got back its deposits. Bengal's savers are not speculators, there are drawn by the promise of high returns nor are the real estate and media organizations. They might absorb surplus funds and yield additional revenue. No doubt they earn political gratitude. But the main business of the mushroom schemes with fancy names is to rob Peter to pay Paul. Since there is little productive activity or income generation, one saver's capital is used to pay another saver's interest. Such manipulation is bound to be exposed sooner or later.

## **State to introduce Bill to check Ponzi Schemes**

The Mamata Banerjee Government has decided to bring in a fresh legislation — West Bengal Protection of Interest of Depositors in Financial Establishments Bill 2013 — to make stringent action against fraud by chit fund operators possible and to keep provisions for harshest action against offenders.

The Governor has approved the new Bill for enforcing the anti-chit fund law. The anti-chit fund Bill that had been sent by the erstwhile Left Front Government to

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<sup>3</sup>Sunanda K. Datta Ray; *Something to Bank On: The chit fund scandal shows that small savers have few options*. Pub: *The Telegraph*, Calcutta, India, Saturday, April 27, 2013.

<sup>4</sup>*Ibid.*

the Centre has been returned to the Governor. It has been specified by sources that the Bill will be made effective with retrospective effect. However, the Opposition has been screaming loud that it is not possible to give a retrospective effect to a new Bill and alleged that the State Government was deliberately bringing a new Bill to shield the recent humungous scam committed by the Saradha Group.

The previous Bill passed by the Left Front in 2009, was equipped to deal with the current situation. However, the Chief Minister's zeal for a new anti-fraud Bill could delay action against Saradha for months but has only a few differences with the old Left-sponsored Bill her government has withdrawn. Except for three provisions and a few other minor changes, the language of the two bills is identical.

Had the Chief Minister wanted to be armed with a Bill immediately she could have first pressed for presidential assent to the old bill — in limbo since its passage in 2009 — and then added the new provisions through amendments. The amended Bill could have been enacted in less than a month but the Chief-Minister vehemently opposed acceptance of a bill moved by the Left with minor amendments. But some lawyers have cited the possibility of legal challenges further delaying the new bill's enactment as it seeks retrospective application.

Former law minister Rabinal Moitra expressed that the provision, in clause 22(2) of the Bill, may expose the bill to legal challenge as Retrospective effect cannot be given to a bill with penal provisions. If the old bill was enacted, its provisions would have applied from the day it was passed in 2009 and no retrospective effect would have been needed.<sup>5</sup>

## **Measures to Reform the Situation in Bengal**

With the Saradha scam coming to light and its resultant panic gripping investors in such companies popularly known as “chit funds”, and rendering the people on a withdrawal mode from such firms, banks are hoping to get more business. The scam has also alerted the central ministry. In the meantime the central ministry has decided to set up a Special Task Force under its Corporate Ministry. It has also been decided to increase the scope and powers of the SEBI (Securitisation and Exchange Board of India.) so that without permission and direction of any authority SEBI can investigate any investment company along with chit fund companies.

Prime Minister Dr. Manmohan Singh said in a programme at Rashtrapati Bhawan, “The business of unrealistic promises of returning the money of masses with high

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<sup>5</sup>*After dragging feet, dose of tinkering — New bill carries risk of delay, The Telegraph*, Calcutta India, April 23, 2013; Available at: [http://www.telegraphindia.com/1130428/jsp/frontpage/story\\_16836948.jsp](http://www.telegraphindia.com/1130428/jsp/frontpage/story_16836948.jsp); Last accessed on: 3-9-2015.

interest illegally must be curbed. The Supreme Court has also ruled that SEBI must take strong steps with regard to all monetary transactions in the market. But the Centre does not want SEBI to restrict to act as "market controller" only. The scope of SEBI is being increased in such a way so that it can take search, investigate, seize property and freeze a bank account of any investment company without any direction or request.

Besides, it is very important to know the amendments that will be brought about in SEBI law. It has been expressed by the Finance ministry that if any agency collects any money from masses, for the purpose of investment in any scheme it shall come under the purview of 'Collective Investment Scheme'. SEBI has power to control these Collective Investment Schemes (CIS's). But the loophole is, these chit funds have been kept away from CIS and unfortunately do not fall under CIS. They are controlled by a separate Chit Funds Act.

The most common excuse given by these agencies is that, they are not registered in the share market, so SEBI has no authority to intervene in their functioning. Another interesting fact is that, Reserve Bank of India has been vested with power to control these investment agencies other than banks. In some cases these agencies are also controlled by some other authority other than SEBI or RBI. As a result of these legal complications the so called 'chit fund companies' were being able to slip through the ties of law. So it has been decided that all kinds of chit funds, cooperatives, Nidhi, investment agencies whether registered or not in the share market, collects from the masses a total of Rupees 100 crore or more then it will fall under the control of SEBI.

To serve this purpose the definition of 'Collective Investment Scheme' will be newly defined and constructed. SEBI had proposed to set up a new body to control the functioning of these agencies. Instead it has been decided that the powers of SEBI be increased and all these offshoot agencies be controlled by SEBI.

Banks though do not offer a very lucrative return on investment as is done by the so called chit funds, are considered to be the safe-keepers of one's hard earned money. While banks offer interest rates ranging from 4% to 10%, some chit funds offer returns as high as 30 to 40% or even more. Former executive director of UCO Bank, Mr. B.K.Dutta, said, "there has been a flight of capital from banks and post offices during the last three-four years in the state due to mushrooming of these companies. As a consequence, banks have suffered and have been surviving on re-capitalisation by the government."

Echoing a similar sentiment, a senior official of State Bank of India expressed "The bank may be able to garner additional business to the tune of a few thousand crore due to people losing faith in chit funds." He, however added that banks need

not rely on them as they have stable investors and stable business. On the other hand, after the Saradha incident, investors have become disinterested in these companies. So, operators in this segment are having a tough time to run the show.

## The Blame-Game

While the Trinamool Congress is pointing the finger at previous governments for preparing the ground for the scam, there is a perception among investors that the company's political proximity to the State government was a bonus.

In completing its first few initial years in office, the Mamata Banerjee government is under a cloud. Emerging from it will require more than denials from the ruling Trinamool Congress that it was not associated with the company implicated in a massive “chit fund” scam. Protests by lakhs of anguished investors who face the spectre of losing savings they had deposited with the now infamous Saradha Group's chit fund company have risen to a crescendo, and the political blame-game has begun in earnest. Rattled, Trinamool is pointing the finger at the Centre and previous Left Front governments for preparing the ground for the scam. These parties might each have a defence. However, there is no escaping the widespread perception among the duped depositors that they were confident of returns on their money due to the company's proximity to the State government.

The Chief Minister has made her share of announcements of steps to be taken. The question however is how many more suicides of agents or investors will it take for those in positions of powers to act with consequence against the murky world of dubious deposit collection entities, identify those enjoying political patronage, and bring the culprits to book. However, what makes the collapse of the Saradha finance company different from the earlier *Sanchaita Scam* of 1980's is that — Saradha Scam is a part of a bigger business empire that included several media organisations that have also recently been closed down. It is only too well known that they all leaned towards the Trinamool Congress.<sup>6</sup>

The TMCP was left embarrassed after explosive details were revealed through a letter written by Saradha group promoter Sudipta Sen to the CBI on April 6. In the letter, Sen named top politicians, journalists, lawyers as having benefited from his company.<sup>7</sup> Not only was the party's Rajya Sabha MP Kunal Ghosh — the Group

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<sup>6</sup> Marcus Dam, *Chit Fund Troubles for Mamata*; *The Hindu*, April 23, 2013.

<sup>7</sup> Rajdeep Sardesai, *WB chit fund scam: Political blamegame continues as TMC warns of action*, April 24, 2013; Available at: <http://www.ibnlive.com/news/politics/rajdeep-talking-point-story-605171.html>; Last accessed on: 2-9-2015.

Media CEO of Saradha — another of its MPs — Satabdi Roy — was the Group's brand ambassador. Furthermore, the State's Minister for Sports Madan Mitra — considered close to Ms Banerjee — had shared the dais with Sudipta Sen, Chairman and Managing Director of the Group at a company event.<sup>8</sup>

Sen, in his letter alleged that he forayed into the media business because he initially came under vicious attack from Bengal's *Pratidin* newspaper represented by TMC MP's Kunal Ghosh and Srinjoy Bose. His letter also specified that after he bought one 'Channel 10', he entered into an agreement with Bengali Newspaper *Pratidin* that he shall pay ₹60 lakh per month to *Pratidin* and apart from that Kunal Ghosh will also be appointed as the CEO of the channel at a salary of ₹15 lakh per month. Further, Sen alleged that *Pratidin* assured him that because of his agreement, "they will protect his business from the state and central governments and will grant him 'smooth passage' to chief minister Mamata Banerjee."<sup>9</sup>

The political fallout of the scam cannot be overstated. It has silently impacted the prospects of the Trinamool Congress in its *panchayat* elections, as a large chunk of those affected belong to rural areas. Already the Trinamool has been accused by the Left parties and the Congress of working to have pushed back the poll schedule, uncertain of its prospects due to the feuding within the party, and which has only been set to intensify as electoral candidates are determined. As if the ground beneath its feet was not wobbly enough, it has turned even shakier in the wake of the recent developments.

The violence across the State that targeted Left parties and its workers after the roughing up of State Finance Minister Amit Mitra and the heckling of Ms. Banerjee in New Delhi had barely died down when West Bengal is on the boil again. This time around, the government has had its back to the wall in the face of the fury of investors and agents targeting what are increasingly being referred to as a "cheat fund." As it works in the third year in office, the Trinamool Congress is up against a challenge the likes of which it has not experienced and imagined before. Further, the The Apex court had, on May 9, 2014 ordered a Central Bureau of Investigation (CBI) probe into the chit fund scam cases in West Bengal while taking note of allegations that scamsters were getting "patronage" of people in "high positions".<sup>10</sup>

<sup>8</sup>Marcus Dam, *Chit Fund Troubles for Mamata*; *The Hindu*, April 23, 2013.

<sup>9</sup>Rajdeep Sardesai, *WB chit fund scam: Political blamegame continues as TMC warns of action*, April 24, 2013; Available at: <http://www.ibnlive.com/news/politics/rajdeep-talking-point-story-605171.html>; Last accessed on: 2-9-2015.

<sup>10</sup>Ranjit Kumar, *Chit fund scam: Supreme Court asks CBI, West Bengal to resolve issue of manpower*; *The Economic Times* — Politics and Nation; Available at: [http://articles.economictimes.indiatimes.com/2015-07-27/news/64919013\\_1\\_cbi-probe-joint-director-chit](http://articles.economictimes.indiatimes.com/2015-07-27/news/64919013_1_cbi-probe-joint-director-chit); Last accessed on: 2-9-2015.

## Conclusion

It is a moot point whether the central or state government is responsible for criminals who prey on the hopes and aspirations of the poor. Both, is the commonsense answer. New Delhi has been quick to point out it's the state governments job to appoint a regulator under Section 61 of the Chit Funds Act. But whatever the constitutional division of powers between state and centre, the Reserve Bank of India cannot run away from its duty to save the country from the financial equivalent of the law of the jungle. Since the Securitisation and Exchange Board of India had earlier acted against some companies that run dubious investment schemes, it can't shirk the responsibility either. But there are strong suggestions that West Bengal's political establishment, the police who are its hand-maidens (as they are of any party in power) and even the law courts frustrates SEBI moves to protect ordinary citizens.

Now, there lies an important question. Should the government be responsible for the financial loss of the masses? Simple answer is — No. The onus cannot rest upon the government. If a misappropriation committed by an individual or an agency results in our financial loss, we must seek help of the court. The quantum of responsibility and onus and who owes how much, whether any specific person or agency had intentionally misrepresented or whether had followed relevant rules and regulations etc will be decided there. Whereas, it is the duty of the market regulator to check whether or not these investment agencies are cheating on us. In this context it must be said, in our country there has been a long drawling decision making as to who will control these agencies. Reserve Bank of India, Securitisation and Exchange Board of India, Central and the State Government, none has complete powers. Besides right kind of laws are yet to be made.

Question arises whether or not norms are being followed. Why isn't the government keeping a strict watch on this issue so that people don't fall prey to the unethical private investment agencies. It is the moral duty of the government to create an awareness and alert people. Even the previous government cannot avoid and shirk the responsibility. In-fact, their responsibility is much greater because the people should have been made aware when these companies started off with their business.

As long as we get good returns on our investment, we do not question as to how the higher percentage of interest is being given irrespective of prevailing market rates which are quite less. Therefore, it is extremely important to know how are money is being circulated.

Extra income and insecurity has a very close relationship which has been widely discussed in various economic theories. Rules of economics lays down that if a person



gains interest at the rate of 8% p.a.(for example) by investing in a nationalized bank and receives 12% interest from any private agency, then the extra 4% is gained only because the investor is willing to take the risk. As good returns are showered in good times there remains no protection during adverse situation. This is absolutely normal and facts of ordinary risk. When bad intentions creep in the problem reaches a greater extent.

Most importantly, the entente of the government or any political party with such companies is not desirable at all because it creates a false impression on poor, less educated people that the companies are stable and their investments are secure. If the government fails to feel that its' investors are not secure, the companies will flourish without any hindrance. To lighten the degree of risk politically is a wrong.

In our state the relationship between economics and politics and monetary crime and political crime has a long history. A minister of some government directly misappropriates huge funds from government purses and goes to jail instead of spending the money on welfare of the people. Some "government leader" lets away expensive lands to private agencies at throw away prices and some parliamentarian in utter shame tries to prove that he did not know anything.

The unfortunate part of the present story though is that, as opposed to the *Sanchayita* fiasco that involved the middle class mostly, this holocaust has spread farther and wider, precipitating devastation amongst the down and the out. The get rich quick promises easily lured them into the trap and there is no certainty now that they can ever be compensated by selling off the seized properties of the fund houses. Even if they can be part reimbursed, the legal procedures are likely to be painfully long. Further, one suspects that the early subscribers were relatively more affluent and the poor joined in later, attracted by the success of the better off. If so, the first comers had received the benefits smoothly enough and it is the under-privileged now who will bear the cost. As with kitty clubs, therefore, the chit funds too involve a cost–benefit calculus. Only their implications are monstrously crueler.

At the end the responsibility of the central government is not less at all. At a certain time huge amount of money was deposited by middle class people in post office small savings scheme. It has been heard that the commission of the agents had been reduced, which encouraged the agents to work on behalf of these private companies. As a result of which the desire for collection and investment in small savings has dropped drastically. In one word the central government has forced people to shift their investment to private agencies. In such a situation people are left with no alternatives but to get trapped in these private companies. Moreover, there are no banks in remote places. Even if there are any, they are located at a difference of ten to twelve miles. Naturally the people are forced to invest in companies like

chit funds. Inaction to implement laws, lack of encouragement to save in post office small scale savings, absence of bank in remote areas, all combined together have facilitated the chit fund scams in Bengal. The central government has no means to avoid the responsibility. But the problem is the regulators do not work as it should, the poor people like all others have greed that is upward facing and hardly have any choice for good investment. So it is very easy to trap them with one or two rounds of flooding returns. So, all you need to curb this is awareness. And to achieve this we need a true revolution. All political colours must unite and come forward to lend their hands towards the masses to create awareness. Will they eventually? Observation as to what the leaders of Bengal holds for the future is truly a matter of time.